DEPARTMENT OF STATE REVENUE
LETTER OF FINDINGS: 03-0097
Sales and Use Tax
For 1999, 2000, and 2001

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ISSUES

I. Personal Use of Rental Vehicle – Use Tax.

Authority: IC 6-2.5-2-1; IC 6-2.5-5-1 to 70; IC 6-2.5-5-8; 45 IAC 2.2-3-15; Tax Policy Directive 8 (Jan. 2003).

Taxpayer argues that the audit erred when it assessed use tax on automobiles which were purchased for renting to its retail customers.

II. Purchase of Advertising Materials – Use Tax.

Authority: IC 6-2.5-1-1; IC 6-2.5-1-2; IC 6-2.5-3-2(a); 45 IAC 2.2-4-1.

Taxpayer states that the audit improperly assessed use tax on the purchase of advertising materials. Taxpayer claims that a portion of the original purchase price included the cost of exempt services and the cost of exempt postage.

STATEMENT OF FACTS

Taxpayer is in the business of renting automobiles on a short-term basis. Taxpayer operates its business at locations within the state and at locations outside the state. Taxpayer also operates several retail locations which sell or lease used cars and trucks.

The Department of Revenue (Department) conducted an audit review of taxpayer's business and tax records and determined that taxpayer owed additional use tax. Taxpayer disagreed with certain of the audit's conclusions and submitted a protest to that effect. An administrative hearing was conducted during which taxpayer further explained the basis for its protest. This Letter of Findings results.

DISCUSSION

I. Personal Use of Rental Vehicle – Use Tax.

Taxpayer bought automobiles intended for use in its car rental business. When taxpayer bought these vehicles, it did not pay sales tax because the vehicles were intended for use in an exempt manner. The audit found that taxpayer permitted certain of its employees to use the vehicles for personal reasons and concluded that the vehicles were being used – in part – for a non-exempt

purpose. Therefore, the audit concluded that taxpayer owed use tax to the extent that the vehicles were being used for this non-exempt purpose.

Taxpayer buys cars directly from the manufacturer and keeps the cars for approximately four to six months. At the end of that time, taxpayer returns the cars to the manufacturer pursuant to the terms of the parties' "buy-back" arrangement. Depending on the particular type of rental vehicle, the cars have individually accumulated approximately 30,000 to 40,000 miles by the time the cars are eventually returned to the manufacturer.

Taxpayer admits that its employees use the vehicles for personal reasons and describes its policy of permitting employees to use the vehicles as follows: Approximately 10 to 14 of its mid-level management personnel are permitted to borrow vehicles. These employees are permitted to borrow vehicles which have not been rented by the end of the business day. The employees are allowed to keep the car until the next workday.

Taxpayer argues that employee use of the rental vehicles is minimal. Taxpayer estimates that of the 30,000 to 40,000 miles which accumulate during the average time it retains each vehicle, only about .2% of the mileage is attributable to employees' private use. It is taxpayer's contention that employee use of the vehicles does not impact its sales/use tax liability because non-exempt use of a vehicle is only permitted when the vehicle has not been rented to a paying customer by the end of each business day. In other words, allowing employees to use the vehicles does not affect the amount of sales tax taxpayer would be collecting from its paying customers.

The audit employed a method for calculating use tax liability based upon the Department's Tax Policy Directive 8 (Jan. 2003), entitled "Application of Sales and Use Tax to Demonstrator Automobiles." The Policy Directive suggests imposing use tax "at the rate to twenty (20) cents per mile times the Indiana sales tax rate." Alternatively, the Directive suggests that the "dealer may elect to report the use tax on two (2) percent of the dealer's cost of purchasing the vehicle . . . ." Although the Directive relates to "Demonstrator Automobiles" and not to rental vehicles, taxpayer has no quarrel with the methodology chosen by the audit; taxpayer does maintain that the underlying rationale for imposing the tax is flawed.

Indiana imposes a gross retail (sales) tax on retail transactions in Indiana. IC 6-2.5-2-1. The legislature has provided a number of exemptions to the imposition of that tax. *See* IC 6-2.5-5-1 to 70. One of those exemptions is provided at IC 6-2.5-5-8 which states that, "Transactions involving tangible personal property are exempt from the state gross retail tax if the person acquiring the property acquires it for resale, rental, or leasing in the ordinary course of his business without changing the form of the property."

Taxpayer is entitled to obtain its cars without paying sales tax because it is in the business of leasing automobiles. However, 45 IAC 2.2-3-15 states that use tax may be imposed under certain circumstances.

> If any person who issues an exemption certificate in respect to the state gross retail tax or use tax and thereafter makes any use of the tangible personal property covered by such certificate, or in any way consumes, stores, or sells such tangible personal property, where such use, consumption, storage or sale is in a manner which is not permitted by such exemption, such use, consumption, or storage shall become subject to the use tax (or

> such sale shall become subject to the gross retail tax), and such person shall become liable for the tax or gross retail tax thereon.

Taxpayer was entitled to purchase its cars without paying sales tax because it bought the cars for use in its auto rental business. However, to the extent that taxpayer permitted its employees to use the cars in a non-exempt (non-rental) manner, taxpayer became subject to use tax measured by the extent of that non-exempt use. The Department accepts taxpayer's contention that its policy of allowing employees occasional use of the rental car does not affect the amount of sales tax it collects from its paying customers. However, the Department is unable to accept the corollary argument that the state's gross retail tax is calculated by balancing the equities between potential sales and potential use tax liability. Taxpayer's sales tax liability is based upon its "sales" which consists of the amount of money taxpayer receives when it rents its vehicles. The amount of sales tax liability will vary from vehicle to vehicle and from month to month, but sales tax is not measured by the way in which the car is used or by the value of the particular vehicle. On the other hand, the state's use tax is measured by the way in which the car is "used" by the purchaser. If the vehicle is used in an exempt manner, there is no taxable use. If the vehicle is used in a non-exempt manner, then use tax liability accrues. Although the scenario is not likely, taxpayer could purchase a $30,000 car for its business, never succeed in renting the vehicle, never collect sales tax from a single customer, and never use the vehicle in a non-exempt fashion. If there were no sales (rentals) and no non-exempt use, there would be no sale or use tax liability; the state could not – in a subsequent audit – afterwards claim that it had to collect either sales or use tax.

FINDING

Taxpayer's protest is respectfully denied.

II. Purchase of Advertising Materials – Use Tax.

Taxpayer hired an out-of-state company to prepare and mail advertising materials to a listing of customers provided by taxpayer. The out-of-state company originally invoiced taxpayer a single charge for the cost of each order of completed and delivered materials. The audit found that taxpayer owed use tax based upon the price it paid for these materials. Taxpayer has subsequently provided information prepared by the out-of-state company detailing the costs involved in the preparation and delivery of the advertising materials. Those detailed costs specify the price charged for materials, labor, and postage. Taxpayer's contends that it only owes use tax on the price of the materials and that the amount of use tax should be reduced.

IC 6-2.5-3-2(a) states that "An excise tax, known as the use tax, is imposed on the storage, use, or consumption of tangible personal property in Indiana if the property was acquired in a retail transaction, regardless of the location of that transaction or of the retail merchant making the transaction."

In effect, the audit found that taxpayer's purchase of advertising materials constituted a "unitary transaction" under 45 IAC 2.2-4-1. This regulation states as follow:

> (a) Where ownership of tangible personal property is transferred for a consideration, it will be considered a transaction of a retail merchant constituting selling at retail unless the seller is not acting as a "retail merchant."

> (b) All elements of consideration are included in gross retail income subject to tax. Elements of consideration include, but are not limited to:
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> > (1) The price arrived at between purchaser and seller.
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> > (2) Any additional bona fide charges added to or included in such price for preparation, fabrication, alteration, modification, finishing, completion, delivery, or other services performed in respect to or labor charges for work done with respect to such property prior to transfer.
> >
> > (3) No deduction from gross receipts is permitted for services performed or work done on behalf of the seller prior to the transfer of such property at retail.

The regulation derives from IC 6-2.5-1-1 which states that a "'unitary transaction' includes all items of personal property and services which are furnished under a single order or agreement and for which a total combined charge or price is calculated." A "retail unitary transaction" occurs when a retail merchant purchases tangible personal property in his ordinary course of business and then sells that property along with services as a unitary transaction. IC 6-2.5-1-2.

The audit was correct in concluding that taxpayer bought the advertising materials by means of a unitary transaction. There is no evidence that taxpayer negotiated for or purchased the out-of-state company's labor or delivery services separately from the cost of the materials. Taxpayer wanted advertising materials, taxpayer bought advertising materials, and taxpayer paid for advertising materials. The fact that the supplier can now supply detailed information breaking down the original invoice charges does not affect the nature or taxability of the original transaction. Taxpayer did not negotiate or pay for the supplier's services; it did not negotiate or pay for postage stamps. Taxpayer bought advertising materials in a series of unitary transactions, and it owes use tax on those unitary transactions.

FINDING

Taxpayer's protest is respectfully denied.

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